

**Letter of Findings: 01-20130178
Individual Income Tax
For the Years 2010 and 2011**

NOTICE: Under IC § 21 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Business Expenses – Individual Income Tax.

Authority: IC § 6-8.1-5-1(c); IC § 6-8.1-5-4; IC § 6-8.1-5-4(c); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007).

Taxpayer argues that the Department of Revenue erred when it disallowed certain claimed business expenses on its S Corporation's tax returns.

STATEMENT OF FACTS

Taxpayers are shareholders in an S Corporation that operates a tavern. Although Taxpayers filed individual income returns as "married filing jointly" for 2010 and 2011, for simplicity sake, this Letter of Finding will simply refer to "Taxpayer."

The Department of Revenue ("Department") conducted an audit review of Taxpayer's individual income tax returns "due to income adjustments made to the S Corporation."

The Department disallowed certain business expenses which resulted in the assessment of additional individual income tax.

Taxpayer disagreed with the Department's decision and submitted a protest to that effect. Taxpayer waived the right to conduct an administrative hearing and asked that a decision be made based upon the documentation provided. This Letter of Findings results.

I. Business Expenses – Individual Income Tax.

DISCUSSION

On the 2010 and 2011 S Corporation return, Taxpayer claimed an exemption for "Cost of Goods Sold – Cost of Labor." Taxpayer presented cash register Z Tapes to establish that persons hired to provide entertainment at the tavern along with other employees were regularly paid in cash. As explained in the audit report:

The [T]axpayer claims to have paid these expenses with cash out of the cash register. The [T]axpayer's accountant claims no cover charge was ever collected on the nights they had live entertainment or DJs. The [T]axpayer also claims paid outs on a regular basis for "doormen" that they classified as contract laborers.

The audit found that Taxpayer was not able to provide cancelled checks, invoices, or contracts to substantiate the claimed expenses. In addition, Taxpayer admitted that, "no forms 1099 were filed for entertainment at the request of the client." Taxpayer was able to provide a handwritten list of individuals and bands along with the amounts purportedly paid to the individuals and bands. However, the audit found that Taxpayer's handwritten notations did not correspond to the expenses claimed on the S Corporation's returns.

The audit concluded that:

The [T]axpayer's handwritten work papers are not reliable. Taxpayer's documentation only proves that the [T]axpayer rang a paid out through the cash register. There's no proof of the actual amount paid or to whom it was paid.

Taxpayer disagrees and states that the Z Tapes are sufficient to establish that it paid the bands and other employees and that the amounts originally claimed on the S Corporation's returns were correct.

As a threshold issue, it is the Taxpayer's responsibility to establish that the assessment of additional income tax is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

In addition, the law requires that individuals and businesses maintain records sufficient to determine any tax liability. "Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for tax by reviewing those books and records." IC § 6-8.1-5-4. In addition, IC § 6-8.1-5-4(c) provides that, "A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times." IC § 6-8.1-5-4(c).

Taxpayer maintains that the Z Tapes are reliable because the transactions are sequentially numbered, provide a "contemporaneous records of cash disbursed, and that neither state nor federal law exclude cash register tapes."

The Department must respectfully disagree. The receipts simply record different amounts of cash distributed from the S Corporation's registers. All that can be known with any certainty is that someone removed cash from one of the registers. There is nothing to establish how much money was removed, who removed it, or for what purpose the cash was used.

Was the cash used to pay Taxpayer's employees? Perhaps, but there is nothing in the records which definitely establishes that the cash was used to pay wages and salaries because Taxpayer failed to maintain "books and records so that the department can determine the amount, if any, of the person's liability for tax by reviewing those books and records." IC § 6-8.1-5-4. Taxpayer's record keeping falls well below that standard set by IC § 6-8.1-5-4 and, as a result, Taxpayer has failed to meet the standard of establishing that the assessment was "wrong" as set out in IC § 6-8.1-5-1(c).

FINDING

Taxpayer's protest is respectfully denied.

Posted: 08/28/2013 by Legislative Services Agency
An [html](#) version of this document.